

SPECIAL NOTICE

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Manufacturing Machinery and Equipment Exemption

Effective July 1, 1995, businesses engaged in manufacturing activities will not be required to pay sales or use tax on machinery and equipment used directly in manufacturing operations. The exemption applies to purchases of machinery and equipment delivered on or after July 1, 1995. In the case of leased machinery and equipment, the exemption applies to rental payments due on or after July 1. Charges made for labor and services for installing the machinery and equipment are also exempt. (Second Engrossed Substitute Senate Bill 5201, Chapter 3, Laws of 1995, First Special Session.)

A “manufacturing operation” means the manufacturing of articles, substances, or commodities for sale as tangible personal property. The manufacturing operation begins at the point where the raw materials enter the manufacturing site and ends at the point where the finished product leaves the manufacturing site. The term also includes that portion of a co-generation project that is used to generate power for consumption within the manufacturing site of which the co-generation project is an integral part. The term does not include research and development, the production of electricity, or the preparation of food products on the premises of a person selling food products at retail.

Machinery and equipment means industrial fixtures, devices, and support facilities. Machinery and equipment also includes pollution control equipment installed and used in a manufacturing operation to prevent air pollution, water pollution, or contamination that might otherwise result from the manufacturing operation. The exemption does not cover building construction.

For purposes of this exemption, machinery and equipment **does not** include:

- ◆ Hand tools;
- ◆ Property with a useful life of less than one year;
- ◆ Repair parts required to restore machinery and equipment to normal working order;
- ◆ Replacement parts that do not increase productivity, improve efficiency, or extend the useful life of the machinery and equipment;
- ◆ Building fixtures that are not integral to the manufacturing operation that are permanently affixed to and become a physical part of a building. This includes utility systems for heating, ventilation, air conditioning, communications, plumbing, or electrical.

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Manufacturing Machinery and Equipment Exemption Special Notice

Page 2

To be considered used directly in a manufacturing operation, the machinery and equipment must:

- ◆ Act upon or interact with an item of tangible personal property;
- ◆ Convey, transport, handle, or temporarily store an item of tangible personal property at the manufacturing site;
- ◆ Control, guide, measure, verify, align, regulate, or test tangible personal property;
- ◆ Provide physical support for or access to tangible personal property;
- ◆ Produce steam or mechanical power for, or lubricate machinery and equipment;
- ◆ Produce another item of tangible personal property for use in the manufacturing operation;
- ◆ Place tangible personal property in the container, package, or wrapping in which the tangible personal property is normally sold or transported.

The purchaser must provide the seller with a manufacturer's sales and use tax exemption certificate. A sample is attached to this notice. The certificate may be in the suggested format or any other form that provides substantially the same information. **No prior application is required to use the exemption.** Both the buyer and seller are required to retain a copy of the exemption certificate in their records for five years.

Purchasers are required to submit to the Department of Revenue an annual summary of purchases that qualify for this exemption. The sample sales tax summary shown at the end of this notice is due on January 31st of the year following the calendar year the purchases were made. Buyers who make infrequent purchases of exempt items may, at their option, file duplicate(s) of the exemption certificate(s) with the Department instead of filing an annual summary.

A corresponding exemption from the use tax is allowed for persons engaged in manufacturing activities for machinery and equipment used directly in a manufacturing operation. The use tax exemption will be allowed if the user provides the Department of Revenue with an annual summary of exempt equipment. The user may elect to file an exemption certificate with the Department instead of the annual summary. If so, the certificate(s) must be filed within 60 days of the first use of the machinery and equipment in this state.

Please note that the annual summaries for sales tax and use tax are different forms. The certificate is used for both the sales and use tax exemptions.

The exemption certificates and annual summaries submitted by businesses to the Department of Revenue will be used to assess the fiscal impact and effectiveness of the manufacturing tax exemption. Legislative fiscal committees, in consultation with business and labor interests, are required to analyze the economic impacts of the tax exemption and provide a report to the Legislature by December 1, 1999. The data will be provided by the departments of Revenue and Employment Security.

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Changes to Existing Tax Incentive Programs

The new legislation also made changes to other tax incentive programs. This portion of the notice summarizes those changes.

New Business Tax Deferral Program

Under current law, the Department of Revenue could receive applications for the new business tax deferral program until June 30, 1998. With the change to the law, this date is moved up to June 30, 1995. Applications submitted on or before that date may still qualify for the program as long as the applicant starts construction before December 31, 1995. No applications will be approved if they are submitted after June 30, 1995.

If an application is approved and construction begins before December 31, 1995, the applicant can defer payment of sales tax on the total amount of the project. Because machinery and equipment, pollution control equipment, and co-generation equipment directly utilized in a manufacturing process is exempt from sales tax after July 1, 1995, the business will not be required to pay sales tax on that portion of the project. The remainder of the project would still be covered by the tax deferral and repayment provisions under Chapter 82.61 RCW.

Distressed Area Tax Deferral/Exemption

In order to provide a further incentive for businesses to locate or expand operations in eligible areas, the Distressed Area Tax Deferral/Exemption program (which includes a deferral/exemption for building construction or expansion) was amended. Eligible areas include distressed counties (a county of high unemployment), counties adjacent to distressed counties, Community Empowerment Zones, counties containing a Community Empowerment Zone, and timber impact towns with less than 1,200 population. The following changes were made:

- ◆ Before the change in the law, a manufacturer remodeling or expanding an existing facility had to invest at least 25 percent of the true and fair value of the existing plant complex in renovation costs and machinery and equipment in order to qualify for deferral/exemption. This 25 percent test for remodeling or expansion of an existing facility is **eliminated**. The expansion of a qualified building will be eligible for deferral/exemption if floor space or production capacity is increased.
- ◆ The jobs requirement for projects located in distressed areas is **eliminated** except for businesses that locate in a Community Empowerment Zone in a non-distressed county or in a county adjacent to a distressed county. If a manufacturer chooses to locate in one of these areas, and wishes to take advantage of the additional tax benefits provided to distressed program participants, the manufacturer must still create one new Full Time Equivalent (FTE) position for each \$750,000 of qualified investment. The total cost of the investment (including exempt machinery and equipment)

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is considered when determining the eligible portion of the project. The requirement that 75 percent of the required employment positions be filled by residents of a Community Empowerment Zone or adjacent county is unchanged.

- ◆ Co-generation projects are included in the distressed area program to the extent that they are used to generate power for on-site consumption. The requirement that 50 percent of the co-generation facility be owned by the manufacturer is eliminated. To qualify, the co-generation project must be an integral part of the manufacturing operation.
- ◆ Even if the deferral is disallowed because the program requirements are not met (i.e. job creation), the taxes deferred on machinery and equipment do not have to be paid if they would have qualified for the new statewide sales tax and use tax exemption at the time of sale or first use.
- ◆ Any taxes deferred under the previous distressed areas program (Chapter 82.60 RCW) do not have to be repaid on machinery and equipment for lumber and wood industries. This applies only to deferred taxes that have not yet been repaid.

Tax Deferral/Exemption for High Technology Businesses

The tax deferral program for high technology businesses (Chapter 82.63 RCW) took effect January 1, 1995. It allows companies to defer paying sales taxes on qualifying research and development or pilot-scale manufacturing facilities. Under 2ESSB5201, those deferred taxes need not be repaid if program requirements are met. The new legislation also eliminates the requirement that the costs of expansion, renovation, or equipping an existing facility exceed 25 percent of the true and fair value of the existing facility.

If the investment project is used for a non-qualifying purpose during the seven years after the project is operationally complete, the deferred taxes that must be repaid will be pro-rated. The program is still limited to the fields of advanced computing, advanced materials, biotechnology, electronic device technology and environmental technology. The business and occupation tax credit is limited to the same five fields.

To receive a copy of the Manufacturers' Sales and Use Tax Exemption Certificate, Annual Summary—Manufacturers' Machinery and Equipment Purchase Eligible for **Sales** Tax Exemption, or Annual Summary—Manufacturers' Machinery and Equipment Purchase Eligible for **Use** Tax Exemption form visit the Department's web site at <http://dor.wa.gov> or call the Telephone Information Center at 1-800-647-7706.

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